IT 98-0080-GIL 10/14/1998 CAPITAL GAINS (LOSSES)

General Information Letter: An individual is not allowed a deduction for capital losses other than the deduction allowed in computing federal adjusted gross income.

October 14, 1998

Dear:

This is in response to your letter dated June 9, 1998, in which you request a letter ruling. The nature of your letter and the information you have provided require that we respond with a General Information Letter which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. *See* 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter you have stated the following:

> We respectfully request a thorough review and due diligence with respect to the notice and disallowance of capital loss carryover and offset against capital gains in question.
>
> The taxpayer's major source of income is earned as an IRC Section 1256 commodities trader. In 1996, the taxpayer incurred a net IRC Section 1256 contract loss in the amount of ($204,497). Such losses are characterized as capital losses. For federal tax purposes, pursuant to Section 1256 contract loss rules, the taxpayer carried back these losses to offset prior year capital gains for the tax years 1993, 1994, and 1995. In 1995, the taxpayer moved to Illinois from California, and filed an Illinois part year resident tax return. The net IRC Section 1256 losses, for federal purposes, were fully utilized in the carry back period.
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> Pursuant to Illinois law, the starting point for computing a taxpayer's net income is the federal adjusted gross income. So Illinois follows federal treatment of losses. For federal income tax purposes, losses are deductible if they occur in a trade or business or a transaction for profit. The IRC Section 1256 contract losses were incurred by the taxpayer in a transaction for profit. The taxpayer's history as a commodities trader reflects the taxpayer's profit motive and personal risk of loss.
>
> If the taxpayer did not have federal capital gain income in the carry back period, to offset the capital loss incurred then the capital loss would have been carried forward and utilized to offset future year capital gains on the federal tax return, and included in the taxpayer's federal adjusted gross income. If the taxpayer was a resident of Illinois during the carry back period, then the application of the federal treatment of the capital loss carry back would have been applied to the prior year Illinois returns, as reflected in the application of the starting point of the federal adjusted gross income.
>
> The Illinois Law does not address the taxpayer's specific situation. The Illinois Law does address that a taxpayer can not deduct the same item more than once, but does not state that the taxpayer would be disallowed to deduct an item once. It is clear that Illinois follows

the federal treatment of capital losses and offset against capital gains. In applying the Illinois rules, the taxpayer was advised that he should file the Illinois tax return as if the federal IRC Section 1256 contract capital loss was carried forward. There would be a federal / Illinois difference due to the carry back period being available for federal purposes, but not available for Illinois. The starting point of the federal adjusted gross income would be adjusted, as there was no carry back period available for the taxpayer in Illinois. Additionally, as the Section 1256 capital loss was incurred while residing in Illinois, the taxpayer could not offset the capital loss against prior year California capital gains. It is clear that the intent of the Illinois legislature was not trying to hurt the taxpayer's economic impact of downturns in income generation. Clearly the Illinois legislature did not intend to create a loophole for the government to tax only upturns in the commodities market, but disallow the offset of downturns in the market.

For this taxpayer's specific situation, the Illinois tax treatment, pursuant to the law, would follow the federal treatment, and the federal law should be applied to the transaction and taxpayer's change in residence. The taxpayer should not be forced to lose the state treatment, which follows the federal treatment benefits of the Section 1256 contract loss provisions, because he moved to Illinois.

As the taxpayer incurred a substantial loss, it has caused substantial hardship to get back on his feet financially. If the taxpayer is not allowed consistent treatment with other Illinois commodity traders, and is discriminated against because he was not an Illinois resident during the carry back period, the application of the law, which does not address the taxpayer's specific situation, would place him at an unfair disadvantage to his peers in the industry.

In the event that The Illinois Department of Revenue does not apply the rules in the taxpayer's favor, we respectfully request for an abatement of penalties and interest. We believe that the abatement is appropriate because of the absence of willful neglect in connection with any late payment of taxes. It should be noted that the taxpayer relied on the advice of a CPA in the classification and treatment of IRC Section 1256 contract loss for the year in question. The taxpayer exercised ordinary business care and prudence in securing the advice of a CPA with regard for the proper classification and treatment of his trading activities.

Response

Section 202 of the Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 *et seq.*) provides:

> For purposes of this Act, a taxpayer's net income for a taxable year shall be that portion of his ***base income*** for such year except money and other benefits, other than salary, received by a driver in a ridesharing arrangement using a motor vehicle, which is allocable to this State under the provisions of Article 3, less the standard exemption allowed by Section 204 and the deduction allowed by Section 207. (emphasis added)

In the case of an individual, "base income" is defined in Section 203(a)(1) of the IITA provides as follows:

> In the case of an individual, base income means an amount equal to the taxpayer's ***adjusted gross income for the taxable year*** as modified by paragraph (2). (emphasis added)

Section 203(e)(1) defines "adjusted gross income" as follows:

> Subject to the provisions of paragraph (2) and subsection (b) (3), for purposes of this Section and Section 803(e), a taxpayer's gross income, adjusted gross income, or taxable income for the taxable year shall mean the amount of gross income, adjusted gross income or taxable income properly reportable for federal income tax purposes for the taxable year under the provisions of the Internal Revenue Code.

Section 403(a) of the IITA provides that:

> To the extent not inconsistent with the provisions of this Act or forms or regulations prescribed by the Department, each person making a return under this Act shall take into account the items of income, deduction and exclusion on such return in the same manner and amounts as reflected in such person's federal income tax return for the same taxable year.

To summarize these statutory provisions, an individual taxpayer must begin his or her computation of net income subject to Illinois Income Tax for a taxable year using adjusted gross income as actually reported on his or her federal income tax return for that taxable year. Accordingly, a taxpayer who has not carried a 1996 capital loss deduction forward to 1997 for federal income tax purposes may not carry that loss forward to 1997 in determining his or her federal adjusted gross income for use as the starting point in computing base income.

Section 203(h) of the IITA states:

> Except as expressly provided by this Section there shall be no modifications or limitations on the amounts of income, gain, loss or deduction taken into account in determining gross income, adjusted gross income or taxable income for federal income tax purposes for the taxable year, or in the amount of such items entering into the computation of base income and net income under this Act for such taxable year, whether in respect of property values as of August 1, 1969 or otherwise.

None of the modifications for individuals listed in Section 203(a)(2) of the IITA can be construed to allow a capital loss carryforward deduction which has not been properly claimed in computing federal adjusted gross income. Accordingly, in computing Illinois net income for a taxable year, a taxpayer is not allowed a capital loss carryforward deduction other than one taken in computing his or her federal adjusted gross income for that year.

With respect to your request for abatement of interest and penalties, the proper forum for that request is the Board of Appeals. Please find enclosed a Form BOA-1 Board of Appeals Petition which must be used to request abatement of interest and penalties.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Sincerely,

Paul S. Caselton
Associate Chief Counsel -- Income Tax